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PSC DEEMS KU FOREIGN COAL PURCHASE UNREASONABLE

Orders Kentucky Utilities to refund $673,000 to customers;
sets management audit of company's fuel procurement function

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FRANKFORT, KY – The Kentucky Public Service Commission has ruled that Kentucky Utilities Company (KU) imposed unreasonable costs on its customers with its July 2001 purchase of 102,000 tons of Polish coal.

In an order issued today, the PSC ordered KU to refund a total of $673,000 to its 446,000 customers in four equal monthly installments, beginning in March. The Commission also ordered an independent focused management audit of KU's fuel procurement functions. KU will pay for the audit.

The decision on the refund was by a 2-1 vote, with Vice Chairman Gary W. Gillis and Commissioner Robert E. Spurlin in favor and Chairman Martin J. Huelsmann dissenting. All three PSC members agreed on the need for the audit.

Today's action stems from the PSC's routine review of KU's coal purchases. Such reviews are conducted on a regular basis to monitor how electric utility companies are applying the fuel adjustment clause. The fuel adjustment clause is governed by a regulation that permits utilities to adjust their electric rates to reflect fluctuations in the price of coal burned to generate electricity.

The review in this case began in December 2001 and covered KU's coal purchases over a six-month period ending October 31, 2001. The PSC held a public hearing in the case on February 19, 2002. A second hearing was held April 9, 2002, partly to address questions raised by the testimony of KU officials before a committee of the Kentucky House of Representatives.

The PSC's investigation found that:

- From July 2000 through May 2001, KU experienced severe shortfalls in the amount of coal delivered to its Ghent Station near Carrolton. The shortfall of 911,893 tons represented about one-third of the amounts called for under KU's contracts with its coal suppliers. One third of the shortfall was from a single supplier, AEI Coal Sales, Inc., the major supplier of coal to Ghent.

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- KU's efforts to bring deliveries into line with contracts were largely unsuccessful. KU officials testified that AEI demanded an additional $5 per ton above the contract price for coal delivered to Ghent.
- In June 2001, KU issued a solicitation for coal suitable for use at Ghent. Only one of 13 bids – for 400,000 tons of Wyoming coal – was accepted. KU did not contact any of the bidders in an effort to improve the bids.
- In May 2001, Western Kentucky Energy Corporation (WKE) – like KU a subsidiary of LG&E Energy - purchased 150,000 tons of Polish coal. Although WKE is not regulated by the PSC, it bought the Polish coal in part as a potential hedge against shortfalls in deliveries of domestic coal to LG&E Energy's regulated subsidiaries.
- In July 2001, LG&E Energy's top fuel procurement official ordered that 102,000 tons of the Polish coal be transferred to KU and delivered to Ghent.

After examining the evidence, the PSC concluded that:

- Once the shortfall problems arose, KU did not move quickly enough to find replacement coal for the Ghent Station.
- The purchase of Polish coal was motivated by factors other than price and quality, notably a desire by LG&E Energy to put domestic suppliers on notice that the company would use imported coal if necessary.
- The $58.37 per ton cost of the Polish coal was more than KU could have paid for similar quality fuel, had it pursued other options more aggressively.
- KU failed to comply with PSC regulations governing the purchase of fuel from affiliated companies.

As a result, only a portion of the cost of the Polish coal may reasonably be passed on to KU's customers, with the excess fuel charges refunded, the PSC said in its order. Furthermore, "the issues raised in this proceeding call for a broader review of KU's fuel procurement activities," the commission said.

In his dissent, Chairman Huelsmann said he believes that KU had few options for solving its coal supply problems. The decision to reject most of the bids was based on legitimate concerns, he said. Therefore, KU acted reasonably in acquiring the Polish coal, Huelsmann said.

However, Huelsmann concurred with the concerns about the mingling of the coal procurement functions of LG&E Energy's regulated and non-regulated subsidiaries. Those functions should be separated, he said.

The order and dissent in this case may be found on the PSC Web site a www.psc.state.ky.us. The case number is 2000-00497-B.

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